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No. 03-891

IN THE

Supreme Court of the United States

STEVEN H. STERN, Individually, and as Trustee of the Steven H. Stern, Inc. Profit Sharing Plan,

Cross-Petitioners,

v.

DAVID A. GILL, Chapter 7 Trustee,

Cross-Respondent.

ON CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE NINTH CIRCUIT

CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

Where a pension or retirement plan has been ERISA-qualified before a participant files a bankruptcy case, does the plan lose its ERISA qualification where attrition or other changes to the participant population occurs before the bankruptcy petition is filed, but the agency (agencies) that bestowed the ERISA qualifying status in the first instance did not retract the plan's qualification nor did the plan sponsor terminate the plan under ERISA?

PARTIES TO THE PROCEEDING

Petitioner and Cross-Respondent, David A. Gill, is the Chapter 7 Trustee for the bankruptcy estate of Steven H. Stern, debtor.

Respondent and Cross-Petitioner, Steven H. Stern, is the debtor in the Steven H. Stern bankruptcy case, pending in the United States Bankruptcy Court, Central District of California, case number SV 95-16165-KL. Steven H. Stern is also the plan trustee of the Steven H. Stern, Inc., Profit Sharing Plan.

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CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI

Cross-Petitioners, Steven H. Stern, individually, and as the Trustee of the Steven H. Stern, Inc. Profit Sharing Plan (collectively, the "Plan Trustee"), conditionally cross-petition for a writ of certiorari to review the judgment of the Ninth Circuit in this case.

OPINION BELOW

The Order and Amended Opinion (the "Amended Opinion") of the Ninth Circuit Court of Appeals is reported at 345 F.3d 1036. It amends and supersedes a prior Opinion of the Ninth Circuit reported at 317 F.3d 1111. Both Opinions are included in the appendix to the petition for writ of certiorari filed by the Petitioner.

BASIS FOR JURISDICTION

The original petition for writ of certiorari filed by Petitioner David A. Gill, Chapter 7 Trustee was docketed on December 19, 2003. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1) and Rule 12.5 of the Rules of the Supreme Court and is conditional upon this Court's grant of Petitioner's petition for writ of certiorari.

STATUTORY AND REGULATORY PROVISIONS INVOKED

The following statutes and regulations are involved in this case.

11 U.S.C. § 541(c)(2):

A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

29 U.S.C. § 1002(2)(A):

(2)(A) Except as provided in subparagraph (B), the terms "employee pension benefit plan" and "pension plan" mean any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program—

(i) provides retirement income to employees, or

(ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond, regardless of the method of calculating the contributions made to the plan, the method of calculating the benefits under the plan or the method of distributing benefits from the plan.

29 U.S.C. § 1341(a)(1):

(a) General rules governing single-employer plan terminations

(1) Exclusive means of plan termination.

Except in the case of a termination for which proceedings are otherwise instituted by the corporation as provided in section 1342 of this title, a single-employer plan may be terminated only in a standard termination under sub-section (b) of this section or a distress termination under subsection (c) of this section.

29 C.F.R. §§ 2510.3-3:

(a) General. This section clarifies the definition in section 3(3) of the term "employee benefit plan" for purposes of Title I of the Act and this chapter. It states a general principle which can be applied to a large class of plans to determine whether they constitute employee benefit plans within the meaning of section 3(3) of the Act. Under section 4(a) of the Act, only employee benefit plans within the meaning of section 3(3) are subject to Title I.

(b) Plans without employees. For purposes of Title I of the Act and this chapter, the term "employee benefit plan" shall not include any plan, fund or program, other than an apprenticeship or other training program, under which no employees are participants covered under the plan, as defined in paragraph (d) of this section. For example, a so-called "Keogh" or "H.R. 10" plan under which only partners or only a sole proprietor are participants covered under the plan will not be covered under Title I. However, a Keogh plan under

which one or more common law employees, in addition to the self-employed individuals, are participants covered under the plan, will be covered under Title I. Similarly, partnership buyout agreements described in section 736 of the Internal Revenue Code of 1954 will not be subject to Title I.

(c) Employees. For purposes of this section:

(1) An individual and his or her spouse shall not be deemed to be employees with respect to a trade or business, whether incorporated or unincorporated, which is wholly owned by the individual or by the individual and his or her spouse, and

(2) A partner in a partnership and his or her spouse shall not be deemed to be employees with respect to the partnership.

(d) Participant covered under the plan.

(1)(i) . . .

(ii) An individual becomes a participant covered under an employee pension plan—

(A) In the case of a plan which provides for employee contributions or defines participation to include employees who have not yet retired, on the earlier of–

(1) The date on which the individual makes a contribution, whether voluntary or mandatory, or

(2) The date designated by the plan as the date on which the individual has satisfied the plan's age and service requirements for participation, and

(B) In the case of a plan which does not provide for employee contributions and does not define participation to include employees who have not yet retired, the date on which the individual completes the first year of employment which may be taken into account in determining—

(1) Whether the individual is entitled to benefits under the plan, or

(2) The amount of benefits to which the individual is entitled, whichever results in earlier participation.

(2)(i) . . .

(ii) An individual is not a participant covered under an employee pension plan or a beneficiary receiving benefits under an employee pension plan if—

(A) The entire benefit rights of the individual—

(1) Are fully guaranteed by an insurance company, insurance service or insurance organization licensed to do business in a State, and are legally enforceable by the sole choice of the individual against the insurance company, insurance service or insurance organization; and

(2) A contract, policy or certificate describing the benefits to which the individual is entitled under the plan has been issued to the individual; or

(B) The individual has received from the plan a lump-sum distribution or a series of distributions of cash or other property which represents the balance of his or her credit under the plan.

(3)(i) In the case of an employee pension benefit plan, an individual who, under the terms of the plan, has incurred a one-year break in service after having become a participant covered under the plan, and who has acquired no vested right to a benefit before such break in service is not a participant covered under the plan until the individual has completed a year of service after returning to employment covered by the plan.

(ii) For purposes of paragraph (d)(3)(i) of this section, in the case of an employee pension benefit plan which is subject to section 203 of the Act the term "year of service" shall have the same meaning as in section 203(b)(2)(A) of the Act and any regulations issued under the Act and the term "one-year break in service" shall have the same meaning as in section 203(b)(3)(A) of the Act and any regulations issued under the Act.

STATEMENT OF THE CASE

Steven H. Stern is the sole shareholder and president of Steven H. Stern, Inc. ("Stern Inc.") Beginning in 1974, Steven H. Stern began saving for his retirement and while he used a variety of investment vehicles for that purpose, he always maintained his interest in the same Retirement Assets, never

transferring the Retirement Assets to anyone else. Indeed, other than market fluctuations, the corpus of the Retirement Assets has not materially changed since 1989.

As time passed, Congress and the California Legislature established or sanctioned different investment vehicles and Respondent "rolled" his Retirement Assets from one vehicle to another as the applicable laws and pertinent circumstances evolved. Prior to 1992, Stern rolled over the Retirement Assets into an Individual Retirement Account ("Rollover IRA") when the corporate sponsor of a prior corporate plan dissolved in 1989. In 1992, three years before he filed his bankruptcy case, Stern again rolled over his Retirement Assets, this time back into a corporate retirement plan because Margaret Mayersohn had become a full time employee of Stern Inc.[1] and contributions to a plan to provide for her retirement became permissible (the "1992 Rollover"). Consequently, in or about October 1992, the trustees of the Rollover IRA collectively rolled over approximately $1,525,000.00, consisting of all of Stern's fully vested Retirement Assets, into the Steven H. Stern, Inc. Profit Sharing Plan (the "New Plan") as Stern's opening beneficial interest.

As is noted above, Margaret Mayersohn's extended employment with Stern Inc. began in or about April 1992. She became a participant in the New Plan at that point, in its first plan year, in consonance with its eligibility and participation rules. Stern Inc. made regular, annual contributions to the New Plan in the fiscal years ending March 31, 1993 and March 31, 1994 for her retirement account, although nothing was added for Stern's benefit. Neither was

1. Ms. Mayersohn had been an employee for a short time in 1990 as well.

anything withdrawn by him, with two limited exceptions not relevant here. Ms. Mayersohn and Stern were married in March 1994, approximately one year before Stern filed for bankruptcy protection on August 11, 1995.

In 1998, the bankruptcy court found that Stern's Retirement Assets were excluded from the bankruptcy estate because the employee benefit plan qualified under Title I and Title II of ERISA.[2] Thereafter, in March 1999, the Ninth Circuit issued its opinion in *Lowenschuss v. Selnick (In re Lowenschuss)*, 171 F.3d 673 (9th Cir. 1999) which held that "the relevant inquiry in the bankruptcy context is whether, *on the petition date*, Debtor could have enforced under ERISA the Pension Plan's transfer restriction". *Lowenschuss*, 171 F.3d at 680 (emphasis added). Based on the *Lowenschuss* case, and because the qualifying employee (Mayersohn) married the sole shareholder (Stern) before the commencement of the bankruptcy case, both the District Court (sitting as a bankruptcy court of appeals) and the Ninth Circuit ruled that the Retirement Assets were not excluded from the bankruptcy estate.

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2. Petitioner sued to recover the Retirement Assets on a fraudulent transfer theory. He also separately objected to Stern's claim that the Retirement Assets were excluded and/or exempt from the bankruptcy estate. Both the district court and the Ninth Circuit Court of Appeals held that the Retirement Assets were fully exempt under California law and it is the subject of the Petitioner's Petition for Certiorari.

I. REASONS FOR GRANTING THE PETITION

A. *Important Public Issue.*

In *Patterson v. Shumate*, the Court stressed an important policy underlying ERISA, namely the uniform, national treatment of pension benefits. *Patterson v. Shumate*, 504 U.S. 753, 761, 112 S. Ct. 2242, 2248, 119 L. Ed. 2d 519 (1992). The Ninth Circuit's decision in *Stern* creates an exception not otherwise found in the ERISA statues and permits a plan's qualification to ebb and flow due to the mere attrition of employees and regardless of whether the administrative authorities have acted to disqualify the plan (or even specifically declined to do so) or whether the plan sponsor terminated it under ERISA. Given Congress's strict mandates regarding the establishment and termination of ERISA plans, a plan's qualification should not be affected by the happenstance of employee attrition. Stated otherwise, the Ninth Circuit erroneously concluded in *Lowenschuss* that the debtor could not enforce ERISA's restrictions on the bankruptcy petition date, merely because employees who once qualified as non-owner employees were no longer with that company as of the bankruptcy petition date. This decision has already lead to inconsistent results that conflict with Congress's intent in enacting ERISA, including the Ninth Circuit's decision on the point in *Stern*. Since the plan in *Stern* had qualified and nothing had disqualified it prior to his bankruptcy petition date, the debtor in Stern *could* enforce the ERISA restrictions, notwithstanding the fact that he had married the only other qualifying employee prior to his bankruptcy filing.

At least two lower courts have recognized the lack of helpful appellate guidance on the issue of when a plan's

ERISA status ought to be determined. *Leckey v. Stefano*, 263 F.3d 267, 270 n.3 (3rd Cir. 2001); *Glickman v. United States Healthcare Systems of Pennsylvania, Inc.*, 268 F. Supp. 2d 443, 446 n.4 (E.D. Pa. 2003). Accordingly, this Court's guidance will answer an important question of federal law, a question that is already being asked by the lower courts.

B. *Conflicts Among the Circuit Courts.*

The Ninth Circuit's decision directly conflicts with at least two other courts. *In re Baker*, 114 F.3d 636 (7th Cir. 1997) (established qualified pension plan did not lose ERISA status although only remaining participant as of the bankruptcy petition date was the majority shareholder); *Kaler v. Craig (In re Craig)*, 204 B.R. 750 (D.N.D. 1996) ("if debtor and his wife were eligible to participate where there were other employees, they should still be eligible to participate even though the other employee's interests had been paid out"). *Stern* further conflicts with the holding in *Madonia v. Blue Cross & Blue Shield of Virginia*, 11 F.3d 444 (4th Cir. 1993), wherein the Fourth Circuit ruled that the existence of non-employee owners is only relevant to determine whether a plan is qualified under Title I and does not affect whether a non-employee owner may participate in the plan.[3] In addition, the Ninth Circuit's opinion in *Stern* conflicts with the Tenth Circuit's holding that the voluntary attrition of employees does not constitute a partial termination of an ERISA plan. *Anderson v. Emergency Medicine Associates*, 860 F.2d 987 (10th Cir. 1988); *Sage v. Automation Incorporated Pension Plan and Trust*, 845 F.2d 885 (10th Cir. 1988).

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3. Whether a sole shareholder employee may participate in an employee benefit plan is before the Court in *Yates v. Henton*, 287 F.3d 521 (6th Cir. 2002), *cert. granted*, _ U.S. __, 123 S. Ct. 2637, 156 L. Ed. 2d 654 (2003).

II. A GRANT OF CERTIORARI WILL ENABLE THIS COURT TO DETERMINE AN IMPORTANT FEDERAL QUESTION, NAMELY WHETHER CONGRESS INTENDED TO ALLOW JUDICIALLY CREATED EXCEPTIONS TO TITLE I OF ERISA.

When it enacted ERISA, Congress expressed an overriding concern that a pension plan participant's actual receipt of retirement benefits should not be subject to the vagaries of financial misfortune. Congress further enacted extremely narrow rules regarding the termination of such plans and limited the circumstances in which the Plan's funds could be invaded. 29 U.S.C. § 1341(a). Indeed, this Court has routinely recognized and "vigorously enforced ERISA's prohibition on the assignment or alienation of pension benefits, declining to recognize any implied exception to the broad statutory bar." *Patterson v. Shumate*, 504 U.S. 753, 760, 112 S. Ct. 2242, 2241, 119 L. Ed. 2d 519 (1992), quoting *Guidry v. Sheet Metal Workers Nat. Pension Fund*, 493 U.S. 365, 110 S. Ct. 680, 107 L. Ed. 2d 782 (1990).

The Ninth Circuit's decision in *Stern* reinforced its holding that an otherwise qualified plan can lose its qualifying status other than by an enumerated terminating event under ERISA, in this case, by a mere change in the business's work force. The cross-petition for certiorari thus presents the Court with an important complement to *Yates*, already accepted by this Court for decision in Spring 2004.

In *Yates*, the question is whether a 100% shareholder of a corporate employer, partner or sole proprietor qualifies as an "employee" participant under ERISA who is entitled to enforce restrictions against alienation in 29 U.S.C. § 1056(d) and 26 U.S.C. § 401(a)(13). *Yates v. Hendon (In re Yates)*,

287 F.3d 521 (6th Cir. 2002), *cert. granted*, __ U.S. __, 123 S. Ct. 2637, 156 L. Ed. 2d 654 (2003). This case presents an immediate and important opportunity to answer questions *Yates* must inevitably raise, but leave open. While *Yates* addresses who is an "employee" participant relative to an already established ERISA plan, this case provides the Court with the opportunity to resolve questions about whether mere changes to employees' status affects a retirement plan's qualification under ERISA. Because a given employer's employee pool will inevitably evolve, especially in the context of small business owners, this is very important to plan participants whose entire health, welfare and retirement benefits could be affected on a daily basis, and such concerns are certainly heightened during a time of financial crisis. In that case, this question becomes of paramount importance upon the filing of a bankruptcy petition to the debtor, his creditors, trustee and family.

Notwithstanding the Ninth Circuit's holdings in *Stern* and *Lowenschuss*, the pertinent date is the creation of the retirement plan, not the date of bankruptcy. While it is true that most issues concerning the scope or extent of a bankruptcy debtor's assets and liabilities are determined by reference to that debtor's date of bankruptcy, the circumstances before the Court here should be seen to be an important exception.[4]

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4. Indeed, unlike various sections of 11 U.S.C. § 541 and other sections of the bankruptcy code that specifically require scrutiny as of the petition date, 11 U.S.C. § 541(c)(2) is strikingly silent as to the date of scrutiny. *Compare* 11 U.S.C. § 541(a) and 11 U.S.C. § 541(c)(1)(B) to 11 U.S.C. § 541(c)(2). Accordingly, had Congress intended the petition date to control under 11 U.S.C. § 541(c)(2) it would provided that language in the statute.

In most instances where the debtor's date of bankruptcy becomes the focus, the operative issues involve the debtor's own circumstance, typically what she owns on that date, or whether a debt was incurred before or after that date. This is different. Here, the focus is not on something the debtor did or some characteristic of hers (such as ownership, or not, of a thing), but rather the focus is on the status and circumstances of a third party, namely whether the *plan's* status was of type A or type B. There is no logical connection between what happens to a plan and when it happens (once it is qualified), on the one hand; and the date of a participant's bankruptcy case on the other. Hence, this case also presents the Court an important opportunity to clarify how ERISA interacts with the Bankruptcy Code, something it has not had occasion to do since *Patterson*, until *Yates*, and it presents a unique opportunity to perform that clarification as a timely complement to *Yates*.

In the *Stern* case, when it was first formed, the retirement plan in question covered an "owner-employee" like Dr. Yates and an unrelated, non-owner employee. Later, but before the bankruptcy petition in question, the owner-employee (Stern) and the non-owner employee married. In Stern's case (commenced a little more than a year after the marriage), the retirement plan was held not to be ERISA-qualified *as of the bankruptcy petition date*, for want of a non-owner employee. That is, since the non-owner employee was deemed to have lost her non-owner status when she married, the plan was assumed to be disqualified under ERISA in the later bankruptcy case, despite the absence of any rescission of the plan's initial qualification.

While there is superficial logic to this result, upon scrutiny it is easy to see that it is contrary both to the pertinent

statutory language and the logical application of the law and public policy. Since the retirement plan was deemed to have lost its ERISA qualification due to a marriage that left it without non-owner employees, it follows that by this reasoning, the retirement plan could have regained its ERISA-qualified status by an expedient, well-timed divorce. The policy of the federal law should not be that expedient divorces are needed to preserve fully vested retirement funds (or for that matter, to realize any economic benefits), and these machinations would not be necessary if the existing law is clarified to confirm that so long as qualifying employees exist when an otherwise-qualified plan is created, evolving changes in those employees' personal lives do not affect the ERISA-qualification of the retirement plan itself (at least until the agencies that bestowed qualification in the first instance retract it). *See Peterson v. American Life & Health Insurance Co.*, 48 F.3d 404 (9th Cir.), *cert. denied*, 516 U.S. 942, 116 S. Ct. 377, 133 L. Ed. 2d 301 (1995) (relying on language in ERISA that makes it sufficient if a policy is *established* under ERISA, plus case law holding that individual policies are ERISA-qualified if they derive from prior qualified group policies, the court held that a health benefit policy was ERISA-qualified because at the time of its purchase it was intended to fulfill benefit.)

Policy and logic militate for a rule that changing employee circumstances do not disqualify a retirement plan. There are numerous situations where on the one hand, federal law encourages employers to establish pension plans for their employees, but on the other hand, those funds which are purposely dedicated to retirement would be in jeopardy if the attrition of an employer's work force on any given day changes things. For example, consider a corporate business, owned by two shareholders, that employs one non-owner

assistant. The corporation establishes a plan that qualifies under Title I of ERISA and the two shareholders and their assistant faithfully participate in the plan. Years later, the assistant voluntarily terminates his position and the next day, one of the shareholders files for bankruptcy. Under *Stern*, the shareholder's interest in the ERISA plan would not be excluded from the bankruptcy estate, yet it would be if the shareholder had filed for bankruptcy one day sooner. Or, if Owner I filed his bankruptcy petition the day before the assistant left, while Owner II filed his petition the day after, their respective interest in the same plan would be treated very differently in their respective bankruptcy cases, even though only 48 hours separates them. Congress could not have intended such an absurd result and this Court should now clarify that judicially created exceptions to the rules are not permitted.

III. THE NINTH CIRCUIT'S RULING CONFLICTS WITH AT LEAST FOUR OTHER CIRCUITS.

The Ninth Circuit has now ruled—twice—that the qualifying status of pension plan is determined as of the date of the bankruptcy filing of a participant. *Gill v. Stern (In re Stern)*, 345 F.3d 1036, 1041 (9th Cir. 2003); *Lowenschuss v. Selnick (In re Lowenschuss)*, 171 F.3d 673, 680 (9th Cir. 1999). In so doing, it has mandated that the mere attrition of employees can affect the ERISA qualification of a plan. The district court in the Eastern District of Pennsylvania concluded, similar to the Ninth Circuit, that a plan's ERISA qualification (in that case dealing with health benefits) changed from "ERISA-qualified" to non "ERISA-qualified" by the departure of one employee. *Glickman v. United States Healthcare Systems of Pennsylvania, Inc.*, 268 F. Supp. 2d 443 (E.D. Pa. 2003). In its reasoning, the *Glickman* court

noted the lack of any helpful appellate guidance in its reluctant reasoning. *Glickman*, 268 F. Supp. 2d at 446 n.4., citing *Leckey v. Stefano*, 263 F.3d 267, 270 n.3 (3rd Cir. 2001).

The Ninth Circuit's holding is in direct conflict with the Seventh and Eighth Circuits, and perhaps even this Court's own precedent. In *In re Baker*, 114 F.3d 636 (7th Cir. 1997), Jerome Baker and his family operated Bakco Data, Inc., which sponsored a profit-sharing plan. At one point, the Bakco profit-sharing plan had 18 participants. By the time Baker filed for bankruptcy protection, he was the only participant in the plan. In holding that the plan complied with ERISA, the Seventh Circuit reasoned that the facts in *Baker* closely resembled the facts in *Patterson*—"for Shumate was the president and chairman of a closely held corporation, and, by the time of his bankruptcy, the only participant in the firm's pension plan." *Baker*, 114 F.3d at 639. Although Shumate was the only remaining participant, this Court never called into question whether the plan qualified under ERISA. It easily follows that the Court should come to the same conclusion on almost identical facts.[5]

Similarly, the District Court in *Kaler v. Craig (In re Craig)*, 204 B.R. 750 (D.N.D. 1996) ruled that although all of the other employee participants were cashed out of the plan before the bankruptcy petition date, the sole shareholder and his wife remained participants. The court reasoned, "If Craig and his wife were eligible to participate when there

5. Without any statutory reference or legal precedent, the Ninth Circuit in *Lowenschuss* attempts to distinguish *Baker* and *Patterson* by rationalizing that in those cases, the bankruptcy debtor was not the sole owner of the companies sponsoring the pension plan. It is hard to see how that fact alone harmonizes these rulings.

were other employees, they should still be eligible to participate even though the other employee's interest have been paid out." *Craig*, 204 B.R. at 755. In its analysis, the *Craig* court relied on *In re Kaplan*, 162 B.R. 684, 695 (Bankr. E.D. Pa. 1993) in which the bankruptcy court set forth a detailed analysis as to plans that qualify under ERISA as opposed to plans that do not, in the wake of *Patterson*. The *Kaplan* court observed that in bankruptcy cases where the company's plan was held not to be qualified under ERISA, the owner (or the owner's spouse) were the only participants the respective plans *ever* had. In cases where the company's plan qualified under ERISA, the company had other employee participants when the plan was created. Although all of the other employees had been paid out, the owner-beneficiary's interest in the plan remained intact. The facts in this second scenario are the same as the facts in *Patterson* where the Court presumed that the plan was qualified under ERISA and excluded from the debtor's bankruptcy estate. The facts in the second scenarios are likewise the same facts in *Stern* where the Ninth Circuit should have ruled that Stern's interest in the New Plan was excluded from the bankruptcy estate.

The *Stern* decision also conflicts with the Fourth Circuit opinion in *Madonia v. Blue Cross & Blue Shield of Virginia*, 11 F.3d 444 (4th Cir. 1993). In *Madonia*, the Fourth Circuit explained that so long as there are other "employees" to bring the plan within the definition of an employee benefit plan under ERISA, then the sole shareholder and spouse can be participants in the plan. *Madonia*, 11 F.3d at 449-50. In the words of the Fourth Circuit,

> the regulation does not govern the issue of whether someone is a "participant" in an ERISA plan, once the existence of that plan has been established

> [because] once a plan has been established, it would be anomalous to have those person benefitting from it governed by two disparate sets of legal obligations.

Id. This reasoning has been noted approvingly by the Eighth Circuit as well in *Robinson v. Linomaz*, 58 F.3d 365, 369 (8th Cir. 1995) ("we are inclined to believe that the *Madonia* court's approach was correct") although *Robinson* was decided on different grounds.

Finally, the Ninth Circuit's ruling in *Stern* runs contrary to the Tenth Circuit's opinions in *Anderson v. Emergency Associates*, 860 F.2d 987 (10th Cir. 1988) and *Sage v. Automation, Inc. Pension Plan and Trust*, 845 F.2d 885 (10th Cir. 1988) relating to partial termination of a plan. Under ERISA, partial termination automatically vests the participants' interest in the plan. In those cases, the Tenth Circuit ruled that an ERISA plan could not be partially terminated by the voluntary departure of employees. In so holding, the Tenth Circuit reasoned that an employee's decision to leave a company is drastically different than an employer cutting its own work force, and that a plan could not be automatically terminated or even partially terminated by the voluntary departure of employees.

Similarly, had Ms. Mayersohn simply quit her employment at Stern, Inc., under the Tenth Circuit's reasoning the New Plan would not be partially terminated. There is little difference between an employee's decision to leave an employer and an employee's voluntary decision to marry the sole shareholder—particularly since she could have left and *then* married. Accordingly, a review of the case law

demonstrates a conflict with the Fourth, Seventh, Eighth and Tenth Circuits and certiorari should be granted to resolve the conflict once and for all.

CONCLUSION

For the reasons set forth in his opposition to Petitioner's petition for writ of certiorari, Respondent contends that this Court should not accept this case for review. In the event that the Court grants the Petition, however, Respondent submits that, to accord fairness and complete justice in this case, the Court should also grant this Conditional Cross-Petition to clarify that the pertinent date to review whether a plan qualifies as an employee benefit plan under ERISA is the creation date and not the bankruptcy petition date. In addition, the Court should provide guidance as to whether a plan that is otherwise qualified under Title I of ERISA can lose its qualifying status by the mere attrition of employees.

Respectfully submitted,

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In The
Supreme Court of the United States

STEVEN H. STERN, etc.,

Cross-Petitioner,

v.

DAVID A. GILL, CHAPTER 7 TRUSTEE,

Cross-Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF IN OPPOSITION

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INTRODUCTION

Cross-Petitioner Steven H. Stern ("Stern") conditionally seeks a Writ of Certiorari ("Conditional Petition") with regard to the unanimous conclusion of the Ninth Circuit Court of Appeals, as well as of the District Court below it, that the pension plan was not excluded from Stern's bankruptcy estate because, on the petition date, there was no covered employee. Stern seeks a Writ of Certiorari on this point only in the event that this Court grants Petitioner, David A. Gill, Chapter 7 Trustee ("Trustee") his Writ of Certiorari ("Petition"). The core of the Conditional Petition is the assertion that the Ninth Circuit's Amended Opinion below " . . . creates an exception not otherwise found in the ERISA statutes and permits a plan's qualification to ebb and flow due to the mere attrition of employees . . . " Conditional Petition at page 9. The Amended Opinion, it is asserted, conflicts with the decisions of other circuits, Conditional Petition at page 10, and presents a body of questions that will arise upon this Court's consideration of the case now before it, *Yates v. Hendon*, ___ U.S. ___, 123 S.Ct. 2627 (2003), Conditional Petition at page 12. The Conditional Petition should be denied even upon the granting of the Trustee's Petition. The issue made the subject of the Conditional Petition, is neither of sufficient importance, nor is it the subject of conflict among the circuits, to merit granting the Conditional Petition.

ARGUMENT

Analysis begins with the applicable statutes. As set forth at page 2 of the Conditional Petition, a pension plan is ERISA qualified only " . . . to the extent that by its

express terms or as a result of the surrounding circumstances [it] . . . provides retirement income to employees." 29 U.S. Code § 1002(2)(A)(i). Regulations issued under this section, at pages 3 to 4 of the Conditional Petition, make clear that "[a]n individual and his or her spouse shall not be deemed to be employees with respect to a trade or business, whether incorporated or unincorporated, which is wholly owned by the individual or by the individual and his or her spouse." 29 C.F.R. § 2510.3-3(c)(1).

It is undisputed that on the date of Stern's bankruptcy petition, the very circumstances outlined above described the condition of his plan. The plan covered only Stern, the owner, and his wife. On the face of the applicable regulations, the Ninth Circuit correctly concluded that the plan was not ERISA qualified, hence not excluded from Stern's bankruptcy estate.

To avoid this result, the Conditional Petition argues that the Amended Opinion of the Ninth Circuit below erroneously ignores the problem of the "ebb and flow" of qualification after formation of a plan, Conditional Petition at page 9. In this, Stern mischaracterizes the issue. This case does not present an issue of plan termination as suggested by Stern's citation of 29 U.S. Code § 1341 at page 3 of the Conditional Petition. Those termination provisions were designed, as the Ninth Circuit itself noted in its prior decision of *In re Lowenschuss*, 171 F.3d 673 (9th Cir. 1999), cert. denied, 528 U.S. 877 (1999) to give notice to those whose interests are impacted. By contrast, in *Lowenschuss* and here, the debtor occupied all the positions. He was the sole shareholder of the corporation (Conditional Petition at page 6), plan administrator (Petition, Appendix 62), and as of the petition date, Stern

was the husband of the only employee formerly participating in the plan. For these reasons, here, as in *Lowenschuss*, the purposes of the ERISA termination provisions to protect arm's length employees from abuse is absent, there was no such arm's length employee to protect. The "ebb and flow" issue is therefore not present and the Ninth Circuit correctly assessed the issue of plan qualification as of the date of the bankruptcy petition.

The sole owner of a corporation is not an employee for purposes of ERISA, nor are the owner and spouse, and this has been uniformly held. *See Matinchek v. John Alden Life Ins. Co.*, 93 F.3d 96 (3d Cir. 1996) (holding that plan covering only sole business owner and his or her immediate family members cannot qualify as employee welfare benefit plan under ERISA); *Peterson v. American Life & Health Ins. Co.*, 48 F.3d 404 (9th Cir. 1995) (same); *Meredith v. Time Ins. Co.*, 980 F.2d 352 (9th Cir. 1993) (same); *Fugarino v. Hartford Life & Accident Ins. Co.*, 969 F.2d 178 (6th Cir. 1992) (same); *Kwatcher v. Massachusetts Serv. Employees Pension Fund*, 879 F.2d 957 (1st Cir. 1989) (holding that sole shareholder employed by company he owned was "employer" for the purposes of ERISA); *Schwartz v. Gordon*, 761 F.2d 864 (2d Cir. 1985) (holding that sole proprietors cannot have dual status under ERISA as employer and employee); *In re Watson*, 161 F.3d 653 F.2d 424 (10th Cir. 1981) (holding that sole owner of medical corporation is not an "employee" for purposes of ERISA).

Beyond the plain language of the statute and its purpose being adhered to by the Ninth Circuit, it is clear that the Ninth Circuit is not in conflict with other circuits. The principal conflict asserted is that supposedly with *Madonia v. Blue Cross & Blue Shield of Virginia*, 11 F.3d

444 (4th Cir. 1993), Conditional Petition at page 10. No such conflict exists. In *Madonia*, a two step analysis was adopted. The first step required that the sole owner establish that the employee benefit plan benefited other employees. Only thereafter did the Fourth Circuit seek to determine if a common law employee was a participant. There is no dispute here that there were no other arm's length employees and therefore *Madonia* is inapplicable. Similarly, *In re Baker*, 114 F.3d 636 (7th Cir. 1997) is inapposite. There was no dispute there that multiple employees were involved on the formation of the plan and to the extent that *Baker* then deals with the attrition ("ebb and flow") issue identified in the Conditional Petition, *Baker* is inapplicable here because the attrition issue is not present. This is so because the policy concerns of notice to independent, arm's length employees noted above are not implicated.

Finally, nothing in *Yates v. Hendon* will raise questions that this case could resolve. As noted in the Petition, *Yates v. Hendon* deals with the issue of whether or not, if the debtor is one but not all of a plan's covered employees, the plan has lost its ERISA qualification as to the debtor. It is clear that the question presented to this Court in *Yates* begins with the premise that " . . . a plan whose sole beneficiaries are the company's owners cannot qualify as an employee benefit plan under ERISA." *Yates v. Hendon*, Brief for Petitioner, 2003 WL 21939861 at page 22. From that premise, the proposition presented by the petitioner is stated as: "[i]t is clear from a plain reading of [29 CRF 2510-3-3(a), (b) and (c)] that Yates should not be excluded from being a participant in the Profit Sharing Plan because other non-owner employees participated in the Profit Sharing Plan." *Yates v. Hendon*, Reply Brief, 2003

WL 22437575 at page 8. That is not the fact pattern here. Here, there are no non-owner, or arm's length employees. As noted above, multiple employees implicate different policy issues than the presence of a single individual who is no longer a covered employee. There is no relation between the issues before this Court in *Yates v. Hendon* and the issues here.

CONCLUSION

For all the reasons set forth herein, it is respectfully submitted that even if the Court grants the Petition, it should not grant the Conditional Petition. The Trustee urges the Court to grant his Petition.

Respectfully submitted,

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STEVEN H. STERN, Individually, and as Trustee of the Steven H. Stern, Inc. Profit Sharing Plan,

Cross-Petitioners,

v.

DAVID A. GILL, Chapter 7 Trustee,

Cross-Respondent.

ON CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE NINTH CIRCUIT

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I.

INTRODUCTION

The issue posed by the Conditional Cross-Petition is whether an ERISA-qualified plan can be considered to have lost its qualified status by the mere attrition of employees prior to a given participant's bankruptcy petition date. Stated otherwise, the issue is whether a plan that was properly qualified under ERISA at the outset loses it qualifying status where no administrative action is taken to terminate or disqualify the plan but changes occur in the employer's work force. In addition, the Court is asked to determine when a plan's qualifications should be judged.

Cross-Respondent does not address any of the issues raised in the Conditional Cross-Petition, nor does he adequately address the conflicts among the circuits. Instead, Cross-Respondent summarily dismisses the Conditional Cross-Petition, with no analysis whatsoever. Cross-Respondent's inability to directly confront, much less refute, the Conditional Cross-Petition confirms that this Court should grant it, in the event it grants the Petitioner's petition for writ of certiorari.

II.

ARGUMENT

A. The Cross-Respondent Did Not Address the Important Public Policy Issues Discussed in the Conditional Cross-Petition.

In his Conditional Cross-Petition, Cross-Petitioner stressed several important public policy issues raised by the ERISA qualification aspects of the Ninth Circuit's opinion in *Stern*. These policy issues include the uniform, national treatment of pension benefits;[1] Congress' desire that a participant's interest in a pension plan be safeguarded; and Congress' desire to impose strict limits on the circumstances in which the plan's funds could be invaded. 29 U.S.C. § 1341(a). The Ninth Circuit in the *Stern* decision created a judicial exception to Title I of ERISA because it found that a plan's ERISA's qualification can change on the mere happenstance of employee attrition and without regard to the fact that no statutory formalities relative to the termination of plan benefits were followed. In other words, a plan that previously qualified under ERISA was considered to have lost its ERISA status merely because the previously qualifying employee married another participant prior to the participant's bankruptcy petition date.

While Cross-Respondent acknowledges that employee attrition is an issue, he then completely misstates the point. In his attempt to neutralize the important policy concerns addressed in the Conditional Petition, Cross-Respondent

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1. Conditional Petition at page 9; *Patterson v. Shumate*, 504 U.S. 753, 761, 112 S. Ct. 2242, 2248, 119 L. Ed 2d 519 (1992).

relies on *In re Lowenshuss*, 171 F.3d 673 (9th Cir, 1999), *cert. denied*, 528 U.S. 877 (1999) to support the assertion that the participant's bankruptcy petition date is the operative date for determining a plan's qualifications. Conditional Opposition at pg. 2. However, there is no dispute between the parties that prior to her marriage to Steven H. Stern, Maggi Mayersohn was a qualifying employee of the Steven H. Stern, Inc. Profit Sharing Plan. *Gill v. Stern (In re Stern)*, 345 F.3d 1036, 1039, 1041 (9th Cir. 2003). Since Ms. Mayersohn and Mr. Stern were married before the filing of Mr. Stern's bankruptcy petition, Cross-Respondent submits that no qualifying employee existed *as of the petition date*. Conditional Opposition at pgs. 2-3. However, it is the Ninth Circuit's misguided rationale in the *Lowenshuss* case — the same rationale that it used in the *Stern* decision — that the Court is now called upon to scrutinize. Cross-Respondent never says why *Lowenshuss* was correct, and he intentionally avoids the important policy issues raised in the Conditional Petition, such as the notion that if Stern and Mayersohn strategically divorced the day before Stern filed for bankruptcy, under Cross-Respondent's view, ERISA qualification would spring back to life. It is unlikely that Congress intended that this important plan qualification issue turn on whether the employee divorced the owner prior to the petition date. Cross-Respondent's evasive argument speaks loudly to the importance of these issues and the fact that this Court should provide guidance to all person affected by them.

B. The Conditional Opposition Does Not Refute the Fact That the Ninth Circuit's Ruling Conflicts with the Decisions of Other Circuits.

The Cross-Respondent attempts to distinguish some, but not all, of the cases cited in the Conditional Petition that demonstrate that the Ninth Circuit's opinion conflicts with other circuit decisions. The cases cited in the Conditional Cross-Petition, including this Court's own precedent, the Seventh Circuit and several district court decision, illustrate this conflict. *Patterson v. Shumate*, 504 U.S. 753, 112 S. Ct. 2242, 119 L. Ed. 2d 519 (1992); *In re Baker*, 114 F.3d 636 (7th Cir. 1997); *Kaler v. Craig (In re Craig)*, 204 B.R. 750 (D.N.D. 1996); *In re Kaplan*, 162 B.R. 684 (Bankr. Ed. Pa. 1993). These cases all demonstrate that where the company originally had other qualifying employees, the plan did not lose its ERISA status because those employees were no longer employed by the firm, even if the only remaining participant as of the participant's bankruptcy petition was the majority shareholder, president or chairman of the company. The Ninth Circuit in *Stern* reaches the opposite conclusion.

In order to sidestep the conflict among the circuits, the Cross-Respondent argues that the Stern Plan *never* had a qualifying employee. Conditional Opposition at pg. 4. That assertion is incorrect. *Gill v. Stern (In re Stern)*, 345 F.3d 1036, 1039; 1041 (9th Cir. 2003). Yet that is the only basis upon the Cross-Respondent can distinguish Cross-Petitioner's cited authorities. For instance, while Cross-Respondent acknowledges the Fourth Circuit's opinion in *Madonia v. Blue Cross & Blue Shield of Virginia*, 11 F.3d 444 (4th Cir. 1993), he attempts to distinguish the case by asserting that "there is no dispute here that there were no other arm's length employees and therefore *Madonia* is

inapplicable." Conditional Opposition at pg. 4.[2] That statement is incorrect. *What is without dispute is that Ms. Mayersohn was a qualifying employee and an active participant in the plan prior to her marriage to Mr. Stern.*

Similarly, Cross-Respondent incorrectly applies the Seventh Circuit's opinion in *In re Baker*, 114 F.3d 636 (7th Cir. 1997) because he again omits that Ms. Mayersohn was a qualifying employee. Instead, the Cross-Respondent summarily dismisses the conflict presented in *Baker* by claiming that "the attrition issue is not present." Conditional Opposition at pg. 4.

Moreover, Cross-Respondent does not even address the conflict raised with this Court's own opinion in *Patterson*. Neither does he acknowledge the other cases cited by the Cross-Petitioner such as *Robinson v. Linomaz*, 58 F.3d 365 (8th Cir. 1995); *Anderson v. Emergency Associates*, 860 F.2d 987 (10th Cir. 1988); *Sage v. Automation, Inc. Pension Plan*

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2. Cross-Respondent contends that Cross-Petitioner asserts that the principal conflict is with *Madonia*. Conditional Opposition at pg. 3. However, the Conditional Cross-Petition demonstrates that the "principal conflict" is with the Seventh Circuit, this Court's own precedent and various district court cases. *See Patterson v. Shumate,* 504 U.S. 753, 112 S. Ct. 2242, 119 L. Ed. 2d 519 (1992) (court presumed that the plan was qualified under ERISA even though the bankruptcy petition date, the only remaining employee under the firm's pension plan was the president and chairman of the closely held corporation); *In re Baker*, 114 F.3d 636 (7th Cir. 1997) (relying on *Patterson*, held that plan was ERISA qualified although the only participant as of the bankruptcy petition date was the corporation's majority shareholder); *Kaler v. Craig (In re Craig)*, 204 B.R. 750 (D.N.D. 1996) (plan remained ERISA qualified although all qualifying employees cashed out prior to sole shareholder's bankruptcy petition).

and Trust, 845 F.2d 885 (10th Cir. 1998); *Kaler v. Craig (In re Craig)*, 204 B.R. 750 (D.N.D. 1996) or *In re Kaplan*, 162 B.R. 684 (Bankr. E.D. Pa. 1993). The importance of these cases is discussed in detail in the Conditional Petition.

Cross-Respondent attempts to distinguish *Yates v. Hendon*, 287 F.3d 521 (6th Cir. 2002), *cert. granted*, __ U.S. __, 123 S. Ct. 2637, 156 L. Ed 2d 654 (2003) from this case. However, as pointed out by Cross-Petitioner, this case presents the Court with an important *complement* to *Yates*. The Cross-Petitioner never claimed that the issues were identical.

III.

CONCLUSION

The Cross-Petitioner respectfully submits that the Court should decline to grant the Petitioner's writ of certiorari. In the event, however, that the Petitioner's writ is granted, this Court should also grant the Conditional Cross-Petition to enable it to clarify issues swirling around the uncertainty as to when a plan must qualify as an employee benefit plan under ERISA. In addition, the Court should provide guidance as to whether a plan that is otherwise qualified under Title I of ERISA can lose its qualifying status by the mere attrition of employees.

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INTRODUCTION

David A. Gill, Chapter 7 Trustee ("Trustee"), Petitioner and Cross-Respondent herein, pursuant to Rule 15, subsection 8 of the Rules of this Court, respectfully submits this Supplemental Brief to comment on the effect of this Court's Opinion in *Yates v. Hendon*, 541 U.S. ___ (2004). Cross-Petitioner Steven H. Stern ("Stern") conditionally seeks a Writ of Certiorari ("Conditional Petition") to review the Ninth Circuit's unanimous conclusion in its Amended Opinion that on Stern's bankruptcy petition date his plan was not ERISA qualified because on that date it lacked a covered employee. Stern's Conditional Petition is in part based upon his assertion that this Court's then not yet issued Opinion in *Yates v. Hendon* would deal with issues that in turn would affect that aspect of the Ninth Circuit's Amended Opinion. See the Conditional Petition at pages 9-10. The Trustee urges this Court to conclude that nothing in its Opinion in *Yates v. Hendon* requires the granting of the Conditional Petition.

ARGUMENT

In the Trustee's Brief in Opposition to the Conditional Petition, the Trustee argued that ". . . nothing in *Yates v. Hendon* will raise questions that this case could resolve." Brief in Opposition at page 4. The Trustee argued that the question presented to the Court in *Yates* arose from the premise that ". . . a plan whose sole beneficiaries are the company's owners cannot qualify as an employee benefit plan under ERISA." The question before the Court in *Yates* was the petitioners' contention that Dr. Yates ". . . should not be excluded from being a participant in the Profit Sharing

Plan because other non-owner employees participated in the Profit Sharing Plan." Brief in Opposition at page 4.

The Court in *Yates v. Hendon* now holds:

> "If the plan covers one or more employees other than the business owner and his or her spouse, the working owner may participate on equal terms with other plan participants." *Yates, supra,* Slip Opinion at page 1.

The Court's holding thus confirms the *Yates* petitioners' position.

The facts before the Court in *Yates* were that "[f]rom the Profit Sharing Plan's inception, at least one person other than Yates or his wife was a participant." *Yates, supra,* Slip Opinion at page 3.

In analyzing the Department of Labor's applicable regulation at 29 C.F.R. 2510.3-3 (also cited in the within Conditional Petition and the Trustee's Brief in Opposition), the Court states that the regulation makes clear that "[p]lans that cover only sole owners or partners and their spouses . . . fall outside [ERISA]." *Yates, supra,* Slip Opinion at page 17. The Court further observed in footnote 6 of its Opinion, at page 17 of the Slip Opinion, that "[c]ourts agree that if a benefit plan covers only working owners, it is not covered by Title I. . . . *In re Watson,* 161 F.3d 593, 597 (CA 9 1998)."

The Trustee's analysis in his Brief in Opposition as to what was presented for decision by this Court in *Yates v. Hendon* is thus borne out by this Court's now-issued Opinion in *Yates. Yates* assumes that a plan configured as Stern's was configured on his bankruptcy petition date does not qualify under ERISA. *Yates* holds that an owner

can be a participant in an ERISA qualified plan if there are other non-owner participants. *Yates* says nothing that adversely affects the Ninth Circuit's conclusion that Stern's plan lost its ERISA qualification as of his bankruptcy petition date.

Yates v. Hendon thus does not dispose of anything that affects that aspect of the Ninth Circuit's Amended Opinion dealing with Stern's plan's lack of ERISA qualification on the bankruptcy petition date which is the basis of the Conditional Petition. What *Yates* does leave open, on remand, is the very question that is the subject of the Trustee's Petition, the reach of a trustee's avoidance powers, *Yates*, *supra*, Slip Opinion at page 20. *Yates* does not require that this Court grant the Conditional Petition. It does show that the Trustee's Petition should be granted.

CONCLUSION

For all the reasons set forth herein and in the Trustee's Brief in Opposition, it is respectfully submitted that even if the Court grants the Trustee's Petition, it should not grant the Conditional Petition. The Trustee urges the Court to grant his Petition.

Respectfully submitted,

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